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KENT ECONOMIC
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INSTITUTE

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KEDI ECONOMIC SURVEY

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June 30, 1980

President: Vladimir J. Simunek

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1.0 OVERVIEW AND ASSUMPTIONS

1.01 OVERVIEW

At the present time, there is no consensus among forecasters on the duration or the depth of the current downturn in the economy. Some expect the downturn will cease by the end of this year. Others see it going on through early 1981.

Robert Eggert's survey of major forecasters revealed that the overall average of these predictions yield a GNP (inflation adjusted) declining at an adjusted annual rate of 7 per cent during this quarter from the prior one. The average decline predicted in the third quarter was 4.4 per cent, and in the fourth, it was 1.2 per cent. During the first half of 1981, some growth is expected but it is seen as being far less robust than in past recoveries. The first quarter of 1981 is seen as being in the 8.5 per cent unemployment range. (It is felt at KEDI that it will not be that high.) Some of those surveyed expect it to reach 10 per cent. This certainly qualifies as being pessimistic. Considering real final sales, the view that they will be the worst of any downturn in the postwar period is not uncommon.

Not being too secure in their predictions, some now offer alternative forecasts. Each of these has certain probabilities connected to it. As an illustration, Data Resources, Inc. has come up with four different forecasts. The probabilities included range all the way from 10 to 50 per cent. That certainly covers all bases. One prediction or probability range is bound to be correct. Such techniques are not viewed here as being valid forecasts. They do not provide any real information. Such

a shotgun approach is just hedging. If a person goes to a horse race and bets on all the horses in one race, one of those bets will pay off.

Treasury Secretary Miller views the current decline as easing. By the end of the year, he expects signs of recovery. Labor Secretary Marshall expressed a gloomy view of the unemployment situation. Like some of the forecasters surveyed by Mr. Eggert, he sees the jobless rate as being possibly as high as 8.5 per cent in the first quarter of 1981.

What is the outlook of KEDI? It is expected here that the downturn will last until the third quarter. That quarter will be close to being flat as compared to the second quarter. Compared to some forecasters, that is a bright prospect. The last quarter of the year is seen here in a fairly sunny light. An upturn will start, but it will be mild during the first six months of 1981. In the latter part of that year, the upturn will gain momentum, and faster growth will continue during 1982.

If this current forecast is compared with the KEDI forecast of last month, a somewhat deeper and longer lasting decline can be seen. The main reason for this is the abandonment of the assumption of the Administration's fiscal aid to the economy during this summer. At the present time, such fiscal aid is <u>not</u> likely to take place in 1980. The new forecast by this Institute shows a deeper slump in the third quarter, and a milder gain in the fourth quarter than was presented in last month's issue.

The recently approved Federal aid to state and local governments is a step in the right direction. However, the amount, $0.5 billion, is not large enough to significantly alter the overall performance of the economy.

KEDI now assumes that a larger tax cut, of at least $30 billion,will take effect in 1981. There are definite indications that the Administration has abandoned its publicized goal of a balanced budget.

Courtenay Slater of the Commerce Department, has said that a tax cut is likely next year due to the rising tax burdens that inflation has brought. A tax cut of $18 billion would be needed just to offset the Social Security tax increases and the taxes that have resulted from inflation pushed incomes being taxed at higher rates. The ratio of total personal taxes to personal incomes is estimated at 21.9 per cent for 1980, and 22.7 per cent for 1981 under current laws. According to the Commerce Department, a tax cut of about $36 billion would be needed to return that ratio to the 1978 level of 21 per cent. (And those weren't even the good old days.) Such a cut would be just what the doctor ordered. However, it is not realistic to expect Administration approval of the cost of lowering taxes to the 1978 level just cited.

Around the middle of June, President Carter indicated he was considering tax cuts and more spending if the economy got worse later this year. He ruled out any tax cut this year. He did not rule out action in 1980 that could take effect next year.

The chairman of the Council of Wage and Price Stability, Alfred Kahn, said that a tax cut is inevitable. He sees this as necessary to lessen the tax bite that has grown in size due to inflation. His view is that any cut should be about equally divided between individuals and businesses rather than the traditional form of benefiting individuals more than companies. This Institute agrees with Mr. Kahn.

A new group, the Committee to Fight Inflation, is comprised of former economic policymakers. (Such positions certainly have a high turnover of personnel.) They have gotten together to voice their views. The Committee wants it to be known they oppose tax cuts to combat the economic doldrums and favor business tax cuts that are small in the next two years and more substantial for three years after that.

In a Gallup poll of business leaders, the Wall Street Journal found the vast majority did not approve of Carter's leadership or economic policies. They see inflation as the most pressing problem, not any "recession." About two-thirds of the leading executives in small companies felt that the Administration has not been sympathetic to the problems of business whereas about one-half of leaders in large firms expressed this view.

Criticism surfaced in the Senate when a measure was passed to end the Credit Control Act of 1969 by July of 1981. President Carter made use of that act in the all-too effective program of credit restrictions enacted in March. Those restrictions squeezed tighter than they should have. Those actions were seriously involved in deepening the economic downturn.

In summary, KEDI does not expect the economy to perform quite as badly as many forecasters indicate. By the end of the fourth quarter there will be a slight upturn. The assumption of fiscal first aid during this summer has been dropped here and has led to a downward revision in figures as compared to the last issue. The mounting criticism of Administration economic policy is well deserved.

KEDI FORECAST HIGHLIGHTS

Table 1.0

Indicator	Unit	1978	1979	1980	1985
Gross National Product	bil. const. 72 $	1399.2	1431.7	1432.7	1751.6
Index of Industrial Production	1967 =100	145.2	152.2	146.7	179.1
Capacity Utilization	%	84.3	85.7	80.8	87.8
Unemployment Rate	%	6.0	5.8	7.5	6.1
Private Housing Starts	mil. units	2.020	1.721	1.145	1.950
Car Sales	mil. units	11.3	10.8	8.0	12.9
Implicit GNP Price Deflator	1972 =100	152.1	165.5	180.5	281.8
Consumer Price Index	1967 =100	195.3	217.5	246.5	396.2
Producer Price Index	1967 =100	209.3	236.2	271.3	411.6
Federal Deficit	bil.$	-27.7	-11.2	-26.6	-15.8
Personal Income	bil.$	1717.4	1924.2	2103.6	3356.7
Prime Rate	%	9.06	12.76	13.73	10.16
Mortgage Rate	%	9.30	10.60	11.39	10.04
Currency plus Demand Deposits	bil.$	326.6	363.8	380.2	632.4
Commercial and Industrial Loans	bil.$	230.9	265.7	298.3	506.7

1.02 ASSUMPTIONS

The following assumptions are parts of this forecast. Compared with assumptions incorporated into the May, 1980, forecasts, some changes take place. The forecast data for the third and fourth quarters of 1980 and a part of 1981, have been lowered in real terms.

1. In 1980, approximately 95% of the demand for oil in this country will be met. In 1981 all basic U.S. demands for oil should be met. The weighted price of oil in 1980 will go up to the $34 range. In 1981, it is expected the price will go up to $40, in 1982, to $46 per barrel, and in 1983, to $56 per barrel.

2. It is still too current to develop a longer-lasting assumption for the impact of the Iranian-Mid East crisis. Compared with the December 1979 forecast, slightly higher price increases of energy items and substantially higher defense orders have been considered.

3. No more tightening in fiscal and monetary policies will occur. In the Summer, the Administration and Federal Reserve will ease the conditions in housing and car markets, and for the economy in general.

4. It is assumed that in 1981 the new Administratin will adopt a definite program in fighting the inflation by gradually reducing the excess demand. The Federal Reserve Board will, at long last, begin a policy of setting the limits to the monetary growth by long-term commitments, not just short-term as has been the policy in the past. Price and wage controls must remain the last resort of stabilization policy. For 1982 and consecutive years, we assume that the Administration will pursue a more orchestrated anti-inflation policy.

5. Our foreign trade with China will expand more rapidly starting this year, and will gain a substantial momentum in 1981 and following years.

6. In 1981, and 1982 good harvests are assumed for this country and average production of crops is expected in the U.S.S.R. A low harvest in the U.S.S.R. is expected in 1983. The U.S. 1983 harvest will be average, and the years 1984 and 1985 will bring record crops.

7. It is projected here that the rates of growth in 1980-1982 in the major industrial countries will be as follows for real GNP:

	1980	1981	1982
West Germany	3.0%	2.8%	3.1%
Italy	2.1	2.0	2.6
Japan	2.0	2.0	2.3
Great Britain	1.7	1.6	1.9
France	2.0	2.1	2.2

8. This month the data for the forecast for 1981 and beyond has been changed to include a tax cut of $30 billion which will take effect in 1981.

1.1 REAL GROWTH

(Table 01. on page 12)

There are growing indications that the economic downturn is reaching its lowest point. Again, we have not had two consecutive quarters of decline in GNP which is the most widely used definition of a recession. Despite the popular abuse of the term, the first quarter of this year showed a real gain in GNP of 1.2 per cent. So whatever the second quarter brings, it cannot be the second quarter of decline. It is true, that present economic reports still show more negative than positive news, but most such reports are based on statistics concerning April and May. Some preliminary data for June have shown touches of improvements.

First, the negative news will be outlined. In April, new factory orders were down a seasonally adjusted 5.5 per cent from the March level. Orders for durable goods were down by 6.6 per cent. Orders for nondefense capital goods fell by 1.8 per cent. Factory inventories went up by 1.7 per cent in April. Factory shipments were down by 4 per cent, and the backlog of orders declined very slightly -- 0.1 per cent -- as compared to March.

Construction spending was down by 3.6 per cent in April from the prior month. Between February and March, it had declined by 5.4 per cent.

Steelmakers continue to announce more production cutbacks. The industry was operating at about 59 per cent of capacity. In April, there were 30,000 fewer steelworkers on the job than in the same month a year ago. Added layoffs in May and early June are estimated by those in the industry to have doubled that number to around 60,000. Output may fall to about 50 per cent of capacity in July.

Construction contracts awarded in April were 34 per cent below the level of one year earlier. Contracts for nonbuilding construction were down by 50 per cent.

Retail sales went down in May by 1.5 per cent from the April level. April showed a revised decline of 2.3 per cent from a month-earlier. That is four straight months of decline. If auto sales are excluded, then the May rate was only down by 0.5 per cent. Auto sales were down by a hefty 6.8 per cent between March and April.

Industrial production was down a seasonally adjusted 2.1 per cent in May. That index is also in its fourth month of decline. This weakness shows that the downturn has spread far beyond the housing and auto industries. Overall, production has gone down by 4.7 per cent since January.

During the second quarter, Administration economist estimated the economy was contracting at the rate of 8 per cent. According to KEDI this appears to be roughly correct but the decline may be more depending on more accurate data on inventories and foreign trade for the second quarter of this year. In the May publication of this Institute, it was stated that the second quarter drop would be in the 5 per cent range. That was based on calculations that included fiscal action by the Administration. The assumption was wrong.

The auto industry continues to cut back. June output is expected to be 12 per cent lower than in June of 1975 when sales were last in a severe slump. In May, production was 43 per cent below the total number of cars produced in the same month of 1979.

Auto sales were down by 20 per cent in early June as compared to the year-earlier figure. That was not as severe a decline as might have been expected. However, the total sales for June of 1979 were especially weak, so even the 20 per cent is a bit misleading. During mid-June, sales by U.S. auto firms dropped by 27 per cent, despite the offers of large rebates.

For the year, KEDI predicts total car sales will decline by 26 per cent from the 1979 level. In 1981, a rebound is expected with sales of about 10.5 million units. However, that is still a bit below the 1979 level as the reader can see in Table .01.

Factory shipments of major home appliances were down in May by one-third as compared to May of 1979. The main reasons cited are the drop in housing starts, the drop in existing home sales, and the credit restraints that put the pinch on potential buyers or scared them away from even trying to buy.

There is also good news to help balance the picture. Even though construction spending was down between March and April, the April rate was 2.4 per cent above the year-earlier figure. Steel industry experts point to the deep plunge in output as having the potential to lead to a faster rebound later this year or early next year. Due to the recent drop in mortgage rates, the housing industry will see benefits.

The Conference Board reported that consumer confidence in June gained for the first time in eight months. The index has a base year of 1969-70 when it was at 100. That figure was down toclose to 42 in April. In June it went up to 48. Although, for example, only 15 per cent of the families surveyed said they think business conditions will be better in the next six months, that was a gain from the 9.6 per cent that were in this category in May. Families with plans to buy homes rose to 2.9 per cent from the 2 per cent level of the prior month.

The Index of Leading Economic Indicators declined at a slower rate in May than in April. In May there was a drop of 2.4 per cent from the April level. April, however, showed a 4.1 per cent fall from the prior month. Two of the components went up: stock prices and building permits. The rise in building permits is of significance in projecting the pace of future building.

William Cox of the Commerce Department expressed the view that the third quarter will decline at a rate below that of the drop in the second quarter. He also noted that the housing industry is getting close to starting an upward movement. He expressed the view that even though the late April and May survey of business spending intentions show an inflation adjusted rise of just 1 per cent for this year, given the condition of the economy, it is somewhat encouraging. KEDI agrees with this view.

In terms of agriculture, the prospects for this year appear to be good. A bumper crop of wheat is seen. Despite the wide variations in the weather, with some areas suffering drought, and others too much rain, the overall outlook is good.

Aluminum production, unlike steel, was not down in May. Preliminary figures show a slight gain in the number of tons produced.

While some government economists do not see enough evidence yet to say whether the decline is abating, others do see hints that the declines are leveling out and some upturn can be expected. The chief economist for the Commerce Department indicated that the economy will start on the upward path by late in the fourth quarter. For example, even though new factory orders for durable goods were down by 7.3 per cent in May, that figure is blurred by the swings in aircraft orders. If those are removed, orders for other nondefense capital goods show a seasonally adjusted gain of 5.6 per cent in May. Also, private wages and salaries fell by only 0.1 per cent in May, and personal income showed some gain.

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TABLE 01. REAL GROWTH
(Unless otherwise noted, quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Gross National Product, 1972$	bil.$	1431.7	1444.7	1428.6	1427.1	1430.5	1432.7
Index of Indust. Production	1967=100	152.2	152.1	145.7	143.4	145.7	146.7
Unemployment Rate	%	5.9	6.1	7.7	8.2	8.0	7.5
Capacity Utilization Rate	%	85.7	85.1	80.1	78.9	79.2	80.8
Private Housing Starts	mil. units	1,721	1,330	945	1,104	1,203	1,145
Car Sales	mil. units	10.8	9.5	7.4	7.0	7.9	8.0

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Gross National Product, 1972$	bil.$	1432.7	1435.2	1448.5	1456.9	1467.4	1452.0
Index of Indust. Production	1967=100	146.7	147.8	151.9	153.8	155.9	152.4
Unemployment Rate	%	7.5	7.6	7.2	7.1	6.6	7.1
Capacity Utilization Rate	%	80.8	81.2	82.8	85.4	85.9	83.8
Private Housing Starts	mil. units	1,146	1,132	1,315	1,489	1,496	1,358
Car sales	mil. units	8.0	9.9	10.3	10.8	11.0	10.5

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Gross National Product, 1972$	bil.$	1452.0	1483.2	1498.2	1513.8	1522.4	1504.4
Index of Indust. Production	1967=100	152.4	156.8	158.2	159.7	161.0	158.9
Unemployment Rate	%	7.1	6.6	6.4	6.1	6.0	6.3
Capacity Utilization Rate	%	83.8	86.4	86.6	86.9	86.8	86.7
Private Housing Starts	mil. units	1,358	1,408	1,612	1,747	1,649	1,604
Car sales	mil. units	10.5	10.8	11.1	10.9	11.3	11.0

* Historical Data

1.2 PRICES

(Table 02. on page 15)

The KEDI forecast concerning the gains in prices has been lowered somewhat when compared to the previous issue. The main reasons for the change are related to the elimination of the assumption concerning fiscal first aid to the economy. (No "fiscal" ambulance arrived, not even a Boy Scout with a first-aid merit badge.) Hence, the downturn now is seen as deeper than before with higher unemployment, and, as a result, smaller increases in prices. The rest of the differences between the present and previous forecast is due mainly to the routine revisions of the first quarter 1980 historical price data. The revised KEDI forecast shows a slowdown in the gains in prices in the second half of this year as compared to the first half.

The consensus of economists seem to be that in the latter half of 1980, the consumer price index will rise at a slower rate due mainly to the changes in the prices of energy and housing.

In the first quarter, energy prices raged upward at an annual rate of 64.8 per cent and house-financing costs went up at an annual rate of 43.9 per cent contributing to the 18.1 per cent first quarter annual inflation rate. Fortunately, in April energy prices went up at a lower annual rate of "just" 11.4 per cent. (It is not easy to cheer for 11.4 per cent; but, when compared to over 60 per cent, a sigh of some relief is in order for those looking for silver linings on the energy clouds.)

Many economists see the price gains in the last six months of 1980 as dropping below a 10 per cent annual rate. Some forecast a rate of 8 per cent and there are even those that mention a rate of around 5 per cent which is seen as being short lived.

The forecast by this Institute is not as optimistic as the 5, 8, or 10 per cent rates just cited. For both 1980 and 1981, it is expected here that the inflation rate will be at least 12 per cent. No substantial relief is seen in 1982 or in the immediate subsequent years.

The major components that will contribute to the gains in prices in 1981 are the continued hiking of oil prices by the OPEC nations. Secondly, the weak international position of the dollar, due mainly to the low interest rates in the U.S.A. as compared with rates overseas, will contribute to price gains. In previous issues of this survey, it was stated that one of the negative consequences of the dramatic decline in interest rates in this country will be the decline in the exchange rate of the dollar which pushes up import prices and also exports. The prediction of these consequences are now beginning to be a reality.

Calculations show that if the U.S. interest rates continue to decline significantly, then the expected rate of inflation here will have 1 or 2 per cent more added. That is one of the results of the relationship of interest rates in the world. For example, declines here could mean the current dollar exchange rate of 1.8 German Marks would go to 1.5, adding to inflation here.

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TABLE 02. PRICES AND NOMINAL GNP
(Unless otherwise noted, quarterly data
are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Consumer Price Index, NSA	1967=100	217.5	236.6	244.2	249.8	255.3	246.5
Producer Price Index, NSA	1967=100	236.2	258.7	266.4	275.2	284.8	271.3
Implicit GNP Price Deflator	1972=100	165.5	174.5	178.3	182.6	186.8	180.5
Gross National Product	bil.$	2369.5	2520.8	2547.2	2605.9	2672.2	2586.5
Personal Cons. Expenditures	bil.$	1510.0	1629.5	1646.1	1684.4	1746.0	1676.5
Gross Private Dom. Investment	bil.$	387.3	387.7	390.2	393.8	398.5	392.6

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Consumer Price Index, NSA	1967=100	246.5	260.2	269.9	277.9	282.3	272.8
Producer Price Index, NSA	1967=100	271.3	292.7	297.4	302.0	308.1	300.1
Implicit GNP Price Deflator	1972=100	180.5	190.4	195.1	200.4	205.1	197.8
Gross National Product	bil.$	2586.5	2732.6	2826.0	2919.6	3009.6	2871.3
Personal Cons. Expenditures	bil.$	1676.5	1797.6	1865.6	1933.6	2002.6	1899.9
Gross Private Dom. Investment	bil.$	392.6	408.4	418.2	425.2	431.8	420.9

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Consumer Price Index, NSA	1967=100	272.8	290.2	297.4	302.3	307.8	299.4
Producer Price Index, NSA	1967=100	300.1	322.7	326.2	328.1	332.7	327.4
Implicit GNP Price Deflator	1972=100	197.8	207.3	211.5	215.9	217.7	213.1
Gross National Product	bil.$	2871.3	3074.7	3168.7	3268.3	3314.8	3206.6
Personal Cons. Expenditures	bil.$	1899.9	2040.7	2118.8	2178.7	2221.8	2140.0
Gross Private Dom. Investment	bil.$	420.9	439.3	448.7	460.3	470.5	454.7

*Historical Data

1.3 EMPLOYMENT AND LABOR

(Table 03. on page 17)

Again, due to the elimination of the assumption about fiscal assistance to the economy, revisions in the forecast are necessary. Regarding employment, this change produces higher jobless rates in the second half of this year and in the first half of the following year.

Projections of most economists show that the rate of joblessness will go up at a good clip during the rest of this year. Some forecast a 10 per cent rate which would top the 9 per cent rate reached at the end of the last recession in May, 1975. KEDI does not agree.

Labor Secretary Ray Marshall mentioned that the rate could go up to 8.5 per cent by the early part of 1981, but he was not calling that a prediction.

KEDI forecasts the peak of the jobless rate as being reached in the third and fourth quarters of this year. KEDI predicts the third quarter rate will be 8.2 and the fourth quarter 8.0 per cent. The unemployment rate for the first quarter of 1981 is forecast here at 7.6 per cent. After that, a gradual decline will take place. The reader is referred to Table 03. on page 17 .

1.4 HOUSING

(Table 04. on page 18)

The forecast here concerning housing starts remains basically unchanged. Relative to other forecasters, this Institute remains optimistic. Data here reveal that the bottom of the present downturn will be reached in the third quarter. As can be seen in Table 04., a gradual improvement will take place throughout 1981. However, a more normal level of housing starts, 1.8 million units, will not be reached any earlier than 1982.

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TABLE 03. EMPLOYMENT AND LABOR
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Population	mil.	220.4	221.9	222.6	223.4	224.1	223.0
Civilian Labor Force	mil.	103.3	104.2	104.8	105.2	106.0	105.1
Employed	mil.	97.2	97.8	96.8	96.6	97.5	97.2
-Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
-Non Agriculture	mil.	93.9	94.5	93.4	93.2	94.2	93.8
Unemployment Rate	%	5.80	6.13	7.68	8.19	7.98	7.50

Indicator	Unit	1981	1981				1981
			1	2	3	4	
Population	mil.	223.0	224.7	225.5	226.3	227.1	225.9
Civilian Labor Force	mil.	105.1	106.6	107.0	107.8	108.5	107.5
Employed	mil.	97.2	98.5	99.3	100.2	101.3	99.8
-Agriculture	mil.	3.4	3.3	3.3	3.4	3.3	3.3
-Non Agriculture	mil.	93.8	95.2	96.0	96.8	98.0	96.5
Unemployment Rate	%	7.50	7.62	7.19	7.08	6.63	7.13

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Population	mil.	225.9	228.0	229.2	230.4	231.3	229.7
Civilian Labor Force	mil.	107.5	109.1	109.9	110.7	111.6	110.3
Employed	mil.	99.8	101.9	102.9	103.9	104.9	103.4
-Agriculture	mil.	3.3	3.3	3.4	3.4	3.3	3.4
-Non Agriculture	mil.	96.5	98.6	99.5	100.5	101.6	100.0
Unemployment Rate	%	7.13	6.61	6.40	6.11	5.96	6.27

* Historical Data

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TABLE 04. HOUSING
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Single-Family Housing Starts	mil. units	1,169	801	575	628	675	670
Multifamily Housing Starts	mil. units	.551	529	370	476	528	476
Mobile Homes Shipments	thous units	283	257	198	204	219	220
Housing Permits Issued	mil. units	1,535	965	891	926	964	937
Construction Costs-Commerc.	1972=100	180.2	193.5	197.1	199.2	202.6	198.1
Construction Costs-Resident.	1972=100	178.8	192.1	196.3	199.4	205.8	198.4

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Single-Family Housing Starts	mil. units	670	724	763	901	893	820
Multifamily Housing Starts	mil. units	476	408	552	588	603	538
Mobile Homes Shipments	thous units	220	248	269	280	289	272
Housing Permits Issued	mil. units	937	980	1185	1365	1398	1232
Construction Costs-Commerc.	1972=100	198.1	209.4	216.3	220.1	229.1	218.7
Construction Costs-Resident.	1972=100	198.4	210.5	216.9	219.4	227.2	218.5

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Single-Family Housing Starts	mil. units	820	852	964	1008	996	955
Multifamily Housing Starts	mil. units	538	556	648	639	653	624
Mobile Homes Shipments	thous units	272	281	304	316	302	301
Housing Permits Issued	mil. units	1232	1306	1589	1693	1714	1576
Construction Costs-Commerc.	1972=100	218.7	239.4	248.7	256.8	264.9	252.5
Construction Costs-Resident.	1972=100	218.5	238.2	249.6	256.7	266.7	252.8

*Historical Data

The judgment of many economists are still overly influenced by the depressed April and May housing statistics. In May, housing starts fell by 11.5 per cent from the April level on a seasonally adjusted basis. May starts of this year were off by 49 per cent from the year-earlier level. However, building permits did move up a bit. They gained 2.2 per cent over the April level on an adjusted basis. At the end of June there were indications that housing activity was beginning to revive a little.

KEDI's position concerning the housing market conforms with those that express the view that prices will keep going up. Hence, what could be gained by slight declines in interest rates would be lost due to higher prices. The average sales price for a new house was $73,900 in April. A year earlier that figure was $71,000. The KEDI projection for the end of this year is $75,000 and for the end of 1981: $82,000.

1.5 BUDGETS

(Table 05. on page 21)

The projection here for government budgets has been changed. The basic reasons are the dropping of the estimate of $10 billion in fiscal aid from the federal goverment and the wider deficit projected by KEDI of at least $20 billion for fiscal 1981. (As was mentioned in an earlier section, the 0.5 billion in aid to state governments is a step in the right direction, but it is simply much too small an amount.)

KEDI has always been sceptical about the balanced budget talk in Washington. In fact, as the reader can see in prior issues of this publication, a balanced Federal budget has never been incorporated into the forecasts. Obviously, this Institute agrees with the growing number

of people expressing the opinion that the budget balancing is fictitious. It is appropriate to take delight in quoting Milton Friedman. He refers to the accounting sleight of hand that was used.

> Spending was shifted from fiscal 1981 to fiscal 1980, and tax revenue the other way, in order to 'balance' the 1981 budget by increasing the already large deficit for 1980. Projected spending and revenue for 1981 are calculated on favorable assumptions for budget balance--good economic conditions and high inflation during 1981.

(Newsweek, June 23, 1980, page 68.)

Because of the recessionary impact on taxes and expenditures, the budget will never be balanced in fiscal 1981. Congressional action has made it increasingly clear that no balance will be reached in the budget. Some in Congress expressed the view that everyone knows there really is no balance and that deficits of $20 billion or more are likely.

KEDI has adopted the assumption of a tax cut in 1981. First, the tax cut is necessary, because it will alleviate, at least partially, the UNACCEPTABLE burden of taxes proposed by the Administration. Between 1980 and 1981, inflation is expected to add roughly another $23 billion to individuals' income tax bills. The proposed tax cut now being considered will lessen the tax burden about $300 per family, on the average. However, that is not really much of a dent when it is put in the context of inflation, and the gains in taxes and social security deductions.. The Tax Foundation estimates that in 1980 a family earning $25,000 will pay $619 more in income and social security taxes than in 1979. That same family will lose about $2,700 in purchasing power from the prior year due to inflation.

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TABLE 05. FEDERAL AND STATE AND LOCAL BUDGETS
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Federal Govt.:							
Income Taxes	bil.$	225.0	239.9	248.5	251.1	259.7	249.8
Corporate Profit Tax Accruals	bil.$	78.5	86.8	85.7	86.9	88.4	87.0
Surpl./Deficit	bil.$	-11.2	-22.9	-25.3	-30.7	-27.6	-26.6
State and Local Governments:							
Income Taxes	bil.$	40.7	39.7	40.8	41.6	42.9	41.3
Corporate Profit Tax Accruals	bil.$	14.4	15.6	15.4	15.9	17.0	16.0
Surpl./Deficit	bil.$	24.7	24.6	24.0	23.1	23.6	23.8

Indicator	Unit	1980	1981				1981
			1	2	3	4	
Federal Govt.:							
Income Taxes	bil.$	249.8	270.3	281.6	290.4	302.5	286.2
Corporate Profit Tax Accruals	bil.$	87.0	91.5	94.7	97.8	99.6	95.9
Surpl./Deficit	bil.$	26.6	-25.7	-28.6	-24.2	-21.5	-25.0
State and Local Governments:							
Income Taxes	bil.$	41.3	44.0	45.7	47.1	48.3	46.3
Corporate Profit Tax Accruals	bil.$	16.0	17.8	19.2	21.3	21.9	20.1
Surpl./Deficit	bil.$	23.8	24.5	25.8	27.1	28.1	26.4

Indicator	Unit	1981	1982				1982
			1	2	3	4	
Federal Govt.:							
Income Taxes	bil.$	286.2	314.7	320.9	329.5	331.3	324.1
Corporate Profit Tax Accruals	bil.$	95.9	104.3	109.6	117.3	122.5	113.4
Surpl./Deficit	bil.$	25.0	-19.6	-17.5	-11.4	-10.7	-14.8
State and Local Governments:							
Income Taxes	bil.$	46.3	50.4	51.6	53.2	55.1	52.6
Corporate Profit Tax Accruals	bil.$	20.1	23.2	24.5	25.8	27.2	25.2
Surpl./Deficit	bil.$	26.4	28.6	30.1	31.7	32.4	30.7

* Historical Data

As Louis Rukeyser pointed cut in mid-June, it is likely that Congress will enact some type of relief from the horrendous gains in Social Security taxes. The new maximum which goes into effect in January will rise by $387.38 to $1,975.05. Hikes are scheduled now up to 1987 when the maximum tax will reach $3,045.90 before the social security deduction stops taking a portion of yearly pay.

The second reason a tax cut is necessary is to provide stimulus for new investment and production. Both Republicans and Democrats are aware of the heavy burden of business taxes. New investment and production need to be stimulated.

1.6 INCOME

(Table 06. on page 23)

The forecast numbers for personal income, personal disposable income, earnings and related indicators have been decreased in this issue. The projection for after tax profits during the rest of 1980 has been somewhat reduced.

Recently released data for personal income in May show that it has advanced infinitesimally; it was almost flat when compared with the April estimate. The KEDI projection shows that in the third quarter, personal income will remain almost level with the second quarter. An increase is expected in the last months of this year.

The forecast for 1981 reveals the resumption of the normal trend. That is, compared with 1980, nominal personal income will increase by 12 per cent. The gain in 1982 will be approximately 13 per cent over the former year.

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TABLE 06. INCOME
(Quarterly data are seasonally adjusted at annual rates)

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
Personal Income	bil.$	1924.2	2057.4	2064.5	2106.7	2185.9	2103.6
Personal Dispos. Income	bil.$	1624.1	1737.4	1745.7	1751.3	1794.8	1757.3
Compensation of Employees	bil.$	1459.5	1555.2	1558.7	1570.8	1630.2	1578.7
Corp. Profits After Tax	bil.$	144.6	158.0	156.1	158.9	160.8	158.5
Personal Saving	bil.$	73.2	64.4	69.8	74.6	76.8	71.4
Average Weekly Earnings	$	218.7	224.2	225.3	227.8	229.8	226.8
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Personal Income	bil.$	2103.6	2245.8	2316.9	2382.7	2445.6	2347.8
Personal Dispos. Income	bil.$	1757.3	1820.5	1870.4	2019.6	2098.7	1952.3
Compensation of Employees	bil.$	1578.7	1691.2	1754.3	1821.9	1885.6	1788.3
Corp. Profits After Tax	bil.$	158.5	165.3	168.7	171.2	173.4	169.7
Personal Saving	bil.$	71.4	74.5	76.8	78.1	80.5	77.5
Average Weekly Earnings	$	226.8	231.5	234.7	237.5	239.8	235.9
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Personal Income	bil.$	2347.8	2496.3	2553.9	2620.7	2694.3	2591.3
Personal Dispos. Income	bil.$	1952.3	2131.0	2175.6	2238.4	2296.8	2210.5
Compensation of Employees	bil.$	1788.3	1958.4	2014.1	2064.3	2101.3	2034.5
Corp. Profits After Tax	bil.$	169.7	176.2	178.1	181.0	183.5	179.7
Personal Saving	bil.$	77.5	84.3	87.2	89.6	92.4	88.4
Average Weekly Earnings	$	235.9	242.6	245.4	249.7	254.2	248.0

* Historical Data

The projection of corporate profits shows the leveling for the second, third and fourth quarters of the year. Some increases are expected in 1981. During 1982 and 1983, after tax corporate profits will gain by 15 and 16 per cent, respectively.

1.7 MONEY AND CREDIT

(Table 07. on page 25)

For the second half of 1980, KEDI projects a mild growth in the money supply, M1A, and more significant gains throughout 1981 and subsequent years. In total, growth of 3 per cent is expected in 1980 as compared with the prior year. The resumption of growth will take place in 1981 and 1982: 7 and 9 per cent, respectively. Some faster growth is expected by M2: 1980, +8 per cent; 1981, +10 per cent; and 1982, +12 per cent.

The projection of commercial and industrial loans parallels the forecast concerning the money supply during the remainder of 1980; that is, a gain of 8 per cent. For 1980 as a whole, the gain will average 4.5 per cent. Some faster growth is expected in 1981; +6 per cent. The estimate for 1982 for this category is 9 per cent growth over the prior year.

Consumer credit will remain stagnant for at least the rest of the year. This Institute projects a gradual resumption in growth, mainly in automobile debts, starting in the second quarter of 1981.

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TABLE 07. MONEY AND CREDIT
(Data for "Currency + Demand Deposits" and "Time Deposits, Adjusted" are averages of daily figures; other data are end of period figures)

Indicator	Unit	1979*	1980				1980
			1	2	3	4	
Currency+Demand Deposits M1A	bil.$	363.8	374.8	377.2	384.3	391.5	380.2
Time Deposits, Adjusted M2	bil.$	1471.4	1543.1	1586.2	1599.4	1618.7	1586.9
Consumer Instal. Credit	bil.$	298.2	294.6	295.3	298.7	305.4	305.4
Commerc.and Ind. Loans at Banks	bil.$	265.0	275.9	278.4	289.6	298.3	298.3
Negotiable Cert.of Deposits	bil.$	115.6	117.2	120.3	122.5	127.3	127.3
Mortgages at S&L Assns.	bil.$	475.8	479.3	483.5	494.2	505.6	505.6
Indicator	Unit	1980	1981				1981
			1	2	3	4	
Currency+Demand Deposits M1A	bil.$	380.2	398.7	415.6	422.7	426.1	415.8
Time Deposits, Adjusted M2	bil.$	1586.9	1649.1	1671.3	1690.5	1704.8	1678.9
Consumer Instal. Credit	bil.$	305.4	308.1	311.2	314.4	318.7	318.7
Commerc.and Ind. Loans at Banks	bil.$	298.3	309.2	316.8	325.3	331.8	331.8
Negotiable Cert.of Deposits	bil.$	127.3	130.6	135.2	140.8	146.4	146.4
Mortgages at S&L Assns.	bil.$	505.6	517.4	530.4	538.7	546.7	546.7
Indicator	Unit	1981	1982				1982
			1	2	3	4	
Currency+Demand Deposts M1A	bil.$	415.8	433.2	440.6	449.7	456.8	445.1
Time Deposits, Adjusted M2	bil.$	1678.9	1719.6	1730.4	1748.1	1760.5	1739.7
Consumer Instal. Credit	bil.$	318.7	321.9	323.5	325.7	328.9	328.9
Commerc.and Ind. Loans at Banks	bil.$	331.8	341.0	352.6	358.4	367.8	367.8
Negotiable Cert.of Deposits	bil.$	146.4	152.3	155.1	158.2	162.3	162.3
Mortgages at S&L Assn.	bil.$	546.7	556.2	569.4	577.5	589.2	589.2

* Historical Data

1.8 INTEREST RATES

(Table 08. on page 27)

Recent moves in lowering the interest rates have brought them closer to the one-digit level. Although rates of 9 per cent or so are beneficial to some, for the economy as a whole they are costly.

In mid-June the Federal Reserve lowered its discount rate to 11 per cent from 12 per cent. KEDI assumes that the Federal Reserve's steps in the near future to lower the interest rates will be more cautious. The U.S. rates, at the present time, are dangerously below the rates prevailing overseas, and further declines may destabilize the international value of the dollar.

However, some economists predict that it will not be long before the interest rates drop below the current level. Some foresee a prime rate below 10 per cent during the summer and the continuous decline of other key rates.

KEDI does not agree that further significant declines in interest rates are to be expected. The possible decline of the Federal Reserve discount rate to 10 per cent this summer will still leave the prime rate closer to but above the 10 per cent range.

It is expected here that by the end of this year, interest rates will rebound slightly, reflecting the revival of the demand in the economy. The projection shows that in 1981, the prime rate will fluctuate in the 11-12 per cent range, and mortgage rates on new homes will be in the neighborhood of 11 per cent. Slight gains in interest rates are expected in 1982 and 1983.

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TABLE 08. INTEREST RATES, YIELDS AND SECURITIES PRICES

Indicator	Unit	1979*	1980				1980
			1*	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.19	13.35	10.27	9.75	10.12	10.87
Prime Rate	%	12.76	16.39	15.63	11.10	11.80	13.73
Mortgage Rate, New Homes	%	10.60	11.78	11.59	11.16	11.02	11.39
Aaa Bonds Rate	%	9.63	12.14	11.48	10.28	10.94	11.21
Long Term Govt. Bonds Yield	%	9.33	11.78	10.41	10.14	10.02	10.59
Standard & Poor's 500 Average	1941-43=100	102.83	106.97	101.23	98.27	99.83	101.58

Indicator	Unit	1980	1981				1981
			1	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.87	10.31	10.65	10.59	10.14	10.42
Prime Rate	%	13.73	12.10	12.14	11.86	11.74	11.96
Mortgage Rate, New Homes	%	11.39	11.24	11.38	11.62	11.53	11.44
Aaa Bonds Rate	%	11.21	11.06	10.95	10.83	11.15	11.00
Long Term Govt. Bonds Yield	%	20.59	10.14	10.23	10.45	10.61	10.36
Standard & Poor's 500 Average	1941-43=100	101.58	101.15	104.26	108.34	110.14	105.97

Indicator	Unit	1981	1982				1982
			1	2	3	4	
3 mo Treas.Bills Rate(new issues)	%	10.42	10.85	11.24	11.98	11.74	11.45
Prime Rate	%	11.96	11.36	11.05	11.84	12.36	11.65
Mortgage Rate, New Homes	%	11.44	11.27	11.06	10.87	10.54	10.94
Aaa Bonds Rate	%	11.00	11.24	10.85	10.32	10.04	10.61
Long Term Govt. Bonds Yield	%	10.36	10.11	10.24	10.42	10.65	10.36
Standard & Poor's 500 Average	1941-43=100	105.97	107.26	103.11	101.26	102.18	103.45

* Historical Data

Stock market prices are forecast here as experiencing significant downward movements during the third quarter. A resumption of an upward trend will begin in 1981.

2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

In this issue, consumer price index for the first quarter 1980 has been selected for comparison. Actual data are taken from the U.S. Department of Commerce estimate in Survey of Current Business, April 1980 issue, blue pages (three months average). Forecast data are from Business Forecasts 1980, published by the Federal Reserve Bank of Richmond Va., February 1980, Library of Congress Catalogue Card No: 75-189493. Table below shows the predictions of forecasters and the deviations of forecast data.

Table 2.0 COMPARISONS OF ACCURACY OF PREDICTIONS

CONSUMER PRICE INDEX

(First quarter 1980, 1967 = 100)

Actual: 236.6

FORECASTER Level:	Page in Business Forecasts 1980	Forecast	% of Accuracy
Manufacturers Hanover Trust	20	231.5	-2.2
Chemical Bank	21	232.9	-1.6
First National Bank of Chicago	22	233.8	-1.2
Georgia State University	24	233.1	-1.5
Bankers Trust Company	28	233.9	-1.1
Goldman Sachs	29	234.6	- .8
The Fidelity Bank	30	235.0	- .7
KEDI	31	234.7	- .8
Morgan Guaranty	35	235.1	- .6